

INVESTMENT INSIGHTS

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BEYOND CASH

EDITORIAL VIEW

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- The Covid-19 pandemic has upped the speed of digitisation of financial services
- Online lending, P2P transactions, mobile wallets, cryptocurrencies: fintechs are reshaping the industry
- Regulators will be the ultimate judges, balancing the benefits and risks of an increasingly cashless society

GLOBAL STRATEGY

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- European growth will suffer a setback this quarter, amid the 2nd wave of Covid-19
- As a result, economic policies are to remain expansionary for longer
- Heightened volatility and easing valuations offer an opportunity to selectively add equity exposure

ASSET ALLOCATION

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- Equities - Neutral, taking advantage of uncertainty, volatility and easing valuations to add equity selectively
- Fixed Income - Higher rates are a tail risk in the US, while the euro area is still battling deflationary forces
- Forex - Slight underweight on the EUR, favouring risks diversifiers such as the CHF, USD and JPY

Editorial View

Beyond cash

- The Covid-19 pandemic has upped the speed of digitisation of financial services
- Online lending, mobile wallets, cryptocurrencies: fintechs are reshaping the industry
- Regulators will be the ultimate judges, balancing the benefits and risks of a cashless society

The move towards a cashless society was already happening before the Covid-19 outbreak, albeit at different stages and paces across countries – and age groups. In promoting e-commerce and contactless payments, the pandemic has all but accelerated this trend. Cash continues (for now) to serve as a value storage, with precautionary holdings having even increased during the crisis. Even if its circulation is plummeting. The future definitely looks digital.

Evidence of the reshaping of finance is manifold. Take conventional banks’ share of the industry’s market value: it stood at 96% a decade ago and has, year-to-date, further shrunk from 81% to 72%. Furthermore, US online-banking registrations are up 200%, and that is just in April. Mobile wallet usage? In July, a third of the Singapore street vendors were letting customers pay via QR code and many African governments have now deemed such services essential. The main event is the upcoming IPO of Ant Group: the Chinese online financial “hypermarket”, with 730 million active users of its Alipay app, is poised to raise a record \$34 billion. The planned valuation – well below current Nasdaq “standards” – puts its market cap at over \$300 billion, with a dual listing in Shanghai and Hong Kong.

Ant’s rapid rise to prominence is rooted of course in technology, but also in not having to fight entrenched incumbents. Indeed, when the company was founded 16 years ago as the payment arm of Alibaba, the Chinese state-owned banking system catered mainly to state-owned businesses, leaving small firms and households ripe for an alternative – smartphone era – option.

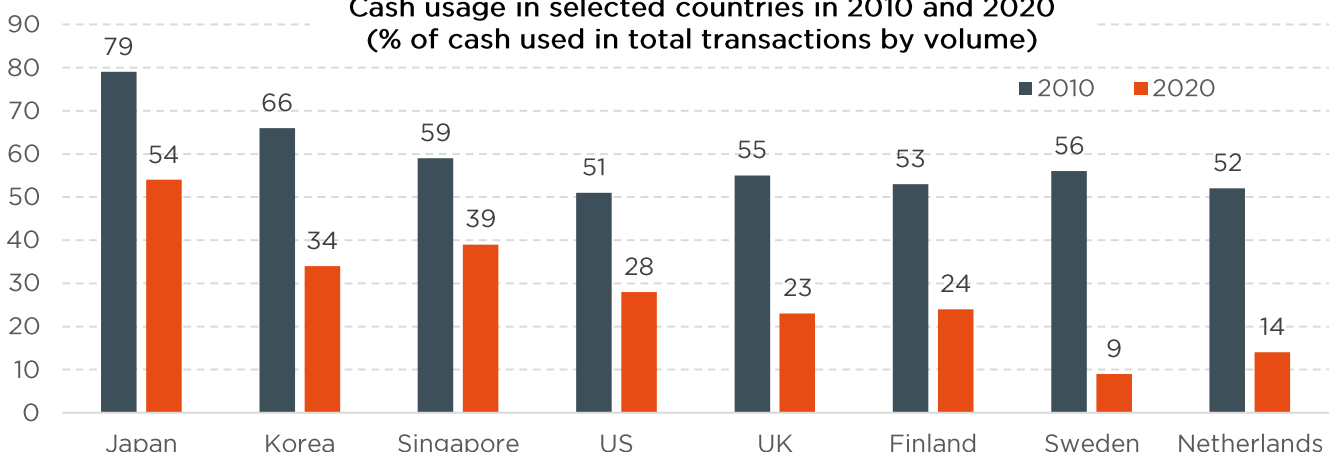
In the West, conventional banks and credit card companies go back a long way. Disrupting them is no easy task, but one that fintechs are actively tackling – from various angles. In digital lending, Nubank has for instance managed to erode the Brazilian banking oligopoly, amassing 30 million accounts over just a few years. In digital payments, including peer-to-peer (P2P) transactions and mobile wallets, Paypal and Square are leading the charge, as reflected by rocketing valuations. As for cryptocurrencies, Facebook’s Libra has obviously garnered much attention. In each case, and as always in the digital space, the key to success lies in generating traffic and exploiting user data.

Ultimately, what share of the pie goes to fintechs will depend on regulators. The benefits of financial digitisation are widely acknowledged: lower operating costs for businesses, less money laundering opportunities, and a tighter grip on tax evasion. But, say critics, it also risks widening inequalities between those who can afford smartphones or other digital interfaces, and those who cannot. Data privacy is another major concern, as is the potential loss of control of the money supply. Which is perhaps why, nudged into action by the Libra, a number of central banks are working on their own “stablecoins” (cryptocurrencies pegged to traditional ones).

So, is it the end of cash? Probably not, since the digitisation of the financial sector does not only come with pros. In many sectors, it has disrupted habits and led to the emergence of a new and large ecosystem of companies undermining conventional banks and forcing them to adapt.

Chart of the Month

Cash usage in selected countries in 2010 and 2020
(% of cash used in total transactions by volume)



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Global Strategy

Short-term angst, medium-term opportunity

- European growth will suffer a setback this quarter, amid the 2nd wave of Covid-19
- As a result, economic policies are to remain expansionary for longer
- Heightened volatility and easing valuations offer an opportunity to selectively add equity

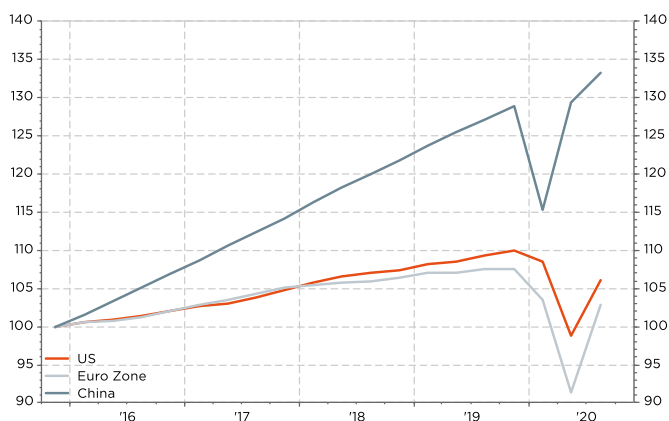
While recent data has confirmed the strong Q3 global rebound, it is already old news as we fast move into another crucial phase. The 2nd wave of the pandemic has forced most European countries to reinstate some form of lockdown, and restrictions are mounting also in the US. This is hurting market sentiment, investors having to push recovery hopes further out in time. Moreover, the much awaited US presidential election is just days away and many companies are reporting results and, more importantly, providing guidance that must be digested. With so many issues to deal with, it would be easy to succumb to the ambient pessimism, essentially related to the lack of short-term visibility.

Looking beyond the valley, we are, however, retaining a cautiously constructive scenario. Equity valuations may seem stretched, be it overall relative to history or in some specific areas, but they still offer ample room for price gains once the dust settles (enabling a lower risk premium and less uncertainty on the earnings front). Also, the macro backdrop is not that bleak – despite an almost certain setback in European GDP growth this quarter. China, like Taiwan and Korea, continues to grow, global manufacturing activity is little affected by the health situation, the US housing market is booming and, last but not least, monetary and fiscal policies are a source of almost unconditional support. Indeed, the ECB is set to recalibrate its easing measures and a new US relief bill should be voted, followed by an infrastructure plan – especially in the likely scenario of a Blue wave. The downside to growth due to new Covid-related restrictions will be met with further policy support. The cherry on the cake? A vaccine

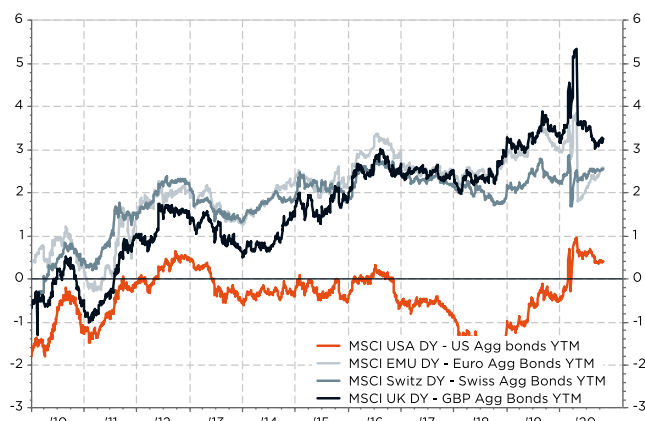
or effective treatment would clearly boost sentiment and accelerate the return to a more normal situation. We thus believe that the economy will continue to heal next year. In turn, we still view the current juncture as a pause that refreshes and reinvigorates animal spirits, allowing markets and indices to take a breather before moving on with different leaders and contributors. Clouds can reasonably be expected to dissipate and reflationary dynamics prevail.

At the portfolio level, our cautiously constructive stance still translates into a neutral equity allocation and a bond underweight. Tactically, we have reduced our sensitivity to US rates, rebalancing holdings into EUR government bonds – seeing an increasing tail risk of higher US rates, while the ECB still faces a deflation threat. In equities, we keep an overall preference for more resilient diversified markets (Switzerland & US), while favouring high quality and large cap stocks. Having already gradually adjusted our style & sector positioning in recent months, trimming our pro-growth bias and adopting a more balanced relative sector stance, we continue to consider taking advantage of heightened volatility and easing valuations to add to equity pockets that are likely to benefit from renewed reflationary forces and a return to a “more normal” health and economic environment. In the same vein, we remain bullish on China owing to a better domestic growth outlook and improving equity fundamentals. Elsewhere, we retain our overweight stance on gold and, in FX, keep a slight EUR underweight for now, preferring the CHF, as well as being comfortable with our current – risk diversifying – USD and JPY exposure.

China, US and Euro Area GDP



Equity DY – Aggregate Bonds YTM



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External sources include: Refinitiv Datastream, Bloomberg, FactSet, McKinsey Global Payments Report 2020

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